

**California Public Employees' Retirement System
Health Care Fund Reserve Policy**

Health Care Fund Reserve Policy

Projected Effective Date: September 26, 2018

The Health Care Fund (HCF) Reserve Policy is effective upon adoption and supersedes any previous HCF Reserve practice.

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A. PURPOSE

The California Public Employees' Retirement System (CalPERS) HCF Reserve Policy (Policy), as adopted by the CalPERS Pension and Health Benefits Committee (Committee), identifies goals and strategies to manage the HCF, and establishes a strategy for developing, reviewing, updating, and handling any HCF surpluses or deficits related to the CalPERS PPO and Flex-Funded Health Maintenance Organization (HMO) health benefit plans.

The HCF funds benefits and administrative expenditures related to health benefit plans that are entirely or partially self-funded and derive from premiums and investment income. The previous reserve practice was developed in 1997 to protect against adverse business and investment risks and other potential future liabilities with the CalPERS PPO plans.

B. PPO Program

I. Background

CalPERS self-funds and self-insures its PPO plans, and is generally responsible for all PPO-related expenditures, even if they exceed premiums and corresponding investment income. Accordingly, it is necessary for CalPERS to carry reserves for its PPO plans.

II. PPO Reserve Components, Purpose, Calculation, and Methodology

The reserves for the PPO plans consist of Medical and Pharmacy Incurred But Not Reported (IBNR) Claim Liability, Continuity of Care Liability, Administrative Liability, and Risk-Based Capital (RBC) components. The following table provides details regarding each component and their corresponding calculation or methodology.

Reserve Component	Purpose	Calculation/Methodology
Medical and Pharmacy IBNR Liability	Covers the estimated liability for IBNR claims that CalPERS may be liable for at the end of a plan year.	Based on the observed claims lag patterns between the time claims are incurred, and the time they are processed for payment.
Continuity of Care Liability	Covers the estimated liability for providing continuity of care for those members who are in the middle of a course of treatment at the time their PPO plan terminates.	Reserve amounts equal 15 percent of the Basic health benefit plan IBNR reserve and 30 percent of the Medicare Supplement health benefit plan IBNR reserve.
Administrative Liability	Covers CalPERS' estimated administrative expenses associated with overseeing the claims runout and wind-down at the time a PPO plan terminates.	Reserve amounts equal to 7.5 percent of the sum of the IBNR and Continuity of Care Liabilities.

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RBC	Covers the estimated liabilities for unexpected claims due to a sudden drop in enrollment, major health event, natural disaster, or other potential causes.	The RBC reserve is based on the National Association of Insurance Commissioners' methodology which is 250% of the required capital level or RBC. This is approximately one and a half months of a PPO plan's medical and pharmacy claims.
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III. Changes in Reserve: Handling PPO Program Surpluses and Deficits

From year to year, individual PPO plan reserves may fluctuate between surpluses (revenue exceeds expenditures) or deficits (expenditures exceed revenue) due to changes to membership, benefit designs, unanticipated healthcare costs, major health events, natural disasters, or other potential causes.

CalPERS intends to handle surpluses or deficits that exceed an actuarially prudent threshold on an individual PPO plan basis as follows and will report any adjustments to the PPO reserves to the Committee during the annual Rate Development Process (RDP).

1. If the assets for an individual PPO plan are at or below 110 percent and no lower than 90 percent of the reserve amount at the end of a plan year, no action will be taken.
2. If the assets for an individual PPO plan exceed 110 percent of the reserve amount at the end of a plan year, CalPERS will make best efforts to use the excess toward the employers and employees that remitted contributions to that individual PPO plan. In many instances, this means CalPERS will use the excess toward the individual PPO plan from which it was generated as expediently and prudently as possible, and if administratively feasible.
3. If assets for an individual PPO plan fall below 90 percent of the reserve amount at the end of a plan year, a surcharge will likely be added to that individual PPO plan's future premium as expediently and prudently as possible, and if administratively feasible, to raise the reserve to an actuarial prudent level.

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C. FLEX-FUNDED HMO PROGRAM

I. Background:

Starting in 2014, payments for administrative services fees and fee-for-service medical and pharmacy claims from Flex-Funded HMOs have come out of the HCF, and beginning in 2019, the Flex-Funded HMOs are responsible for all medical (and pharmacy if applicable) claim expenditures that exceed collected premiums.

While CalPERS is not financially responsible if expenditures exceed premiums as is the case with its PPO plans, it is still possible that premiums could exceed expenditures on an individual Flex-Funded HMO plan basis, thereby creating a surplus. CalPERS intends to handle any individual Flex-Funded HMO plan surpluses as described below.

II. Handling of Surpluses at the End of Each Plan Year

1. At the end of each plan year, CalPERS will review each individual Flex-Funded HMO plan account, analyzing revenues and expenditures, IBNR, and contractually required reconciliations to determine whether there is a surplus. In most years, surpluses, if any, should be minimal, and such small surpluses will remain in a Flex-Funded HMO's account.
2. If CalPERS' staff determines there is a significant surplus, it will make recommendations to the Committee during the RDP regarding the potential use of such surplus toward the employers and employees that remitted contributions to that individual Flex-Funded HMO plan. In many instances, this means CalPERS will use the surplus toward the individual Flex-Funded HMO plan from which it was generated as expediently and prudently as possible, and if administratively feasible.

III. Handling of Surplus After the Close-Out of a Contract

1. At the end of a contract, CalPERS will review each individual Flex-Funded HMO plan account, analyzing revenues and expenditures, IBNR, and contractually required reconciliations to determine whether there is a surplus.
2. If CalPERS' staff determines there is a surplus, it will make recommendations to the Committee during the RDP regarding the potential use of such surplus.
 - a. For Flex-Funded HMO plans with which CalPERS has entered into a new contract, the objective will be to use the surplus toward the employers and employees from which the surplus was generated. This may include using the surplus toward that same individual Flex-Funded HMO as expediently and prudently as possible, and if administratively feasible.

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- b. Where CalPERS has not entered into a new contract with the individual Flex-Funded HMO, the goal will be to use the surplus toward the employers and employees from which the surplus was generated. In some instances, this may entail using the surplus for a plan whose membership includes a significant portion of members from the former Flex-Funded HMO.

D. Reporting and Monitoring

The Policy is dynamic and as necessary, may be revised from time to time to reflect, among other things, changes to CalPERS Health Benefits and Investment Programs, healthcare costs, and economic conditions. Any proposed changes to the Policy are subject to Committee approval. Accordingly, CalPERS staff will continue to monitor and report on the HCF as follows.

Report Content	Frequency	Responsible Party
1. Staff will assess PPO Program and Flex-Funded HMO Program reserves each plan year based on Sections B. and C. above, and will report any changes to the Committee during the RDP.	At Least Annually	Actuarial Office
2. Staff will provide a report to the Committee that includes, but is not limited to, changes in total assets, reserves, and any surpluses and deficits within the PPO and Flex-Funded HMO Programs.	At Least Semi-Annual	Actuarial Office
3. Staff will evaluate the Policy, including, but not limited to, the appropriate reserve level, reserve calculation, method of handing surpluses and deficits, as well as monitoring and reporting requirements.	At Least Every Four Years	Health Plan Administration Division and Actuarial Office

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Date	Details
2004-05-18	RBC reserve of 300% adopted by the Pension and Health Benefits Committee
2018-09-25	Obtain approval by the Pension and Health Benefits Committee for: <ul style="list-style-type: none">• the reducing of the RBC reserve from 300% to 250%;• the handling of excess funds for the PPO and Flex-Funded HMO Programs; and• the reporting and monitoring requirements for this Policy.